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SIPDIS

STATE DEPARTMENT FOR SCA/CEN
TREASURY PLEASE PASS TO LARRY NORTON AND JEFF BAKER

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SUBJECT: TAJIKISTAN -- IMF SEES PROGRESS BUT STILL NOT SURE GLASS IS HALF-FULL

REF: A. 08 DUSHANBE 1502

[1](#)B. DUSHANBE 670

[1](#)C. DUSHANBE 618

[1](#)D. DUSHANBE 846

[1](#)E. DUSHANBE 570

[1](#)F. DUSHANBE 514

[1](#)G. DUSHANBE 508

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REASON: 1.4 (b), (d)

[1](#)1. (C) Summary: After initial assurances that the financial crisis would not affect Tajikistan, government officials now frequently cite dropping remittances, exports, and imports as serious signs of the crisis here. International Monetary Fund Resident Representative Luc Moers said the situation might not be as bad as some say. The decline in exports is exaggerated, inflation is low, and GDP grew by 2.8% over the first six months of the year, surpassing expectations of zero growth. The government has initiated some good economic reforms, most at the behest of the IMF and other donors, but it remains to be seen whether the changes will be effectively implemented. Financial audits of key state entities, including Barqi Tojik, Talco, and the National Bank, will not be made public; Moers, who has seen some of the audit results, said they might not inspire much confidence. On balance he is pleased with the progress of National Bank reforms after the misreporting scandal, and he is cautiously optimistic about the future. He confided he was personally content with the U.S. decision to vote "no" on IMF loans in April, saying it was important that the Tajik government saw sticks, and not just carrots. End summary.

TAJIK ECONOMY: COULD (SHOULD?) BE WORSE

[1](#)2. (SBU) Tajik officials first greeted news of the world financial crisis late last year with assurances that Tajikistan was safe because of its isolated banking sector and undeveloped industrial capacity (ref A). Since then, however, hardly a month goes by without the government convening a roundtable to discuss the effects of the crisis -- and to solicit donor help (refs B and C). The three key statistics cited at these events are: Tajik exports are down by nearly 50% as a result of reduced world demand for the country's two major products, aluminum and cotton. Remittances from Tajiks working abroad are down 35% compared to last year (when they equaled 52% of GDP, the highest ratio on the world). And imports are down between 12% and 15% because of reduced expendable income.

[1](#)3. (SBU) According to Luc Moers, however, the situation may not

be so bleak. To begin with, the decline in exports is not nearly as dramatic as government officials -- and many western aid organizations -- make it out to be. The 50% figure is calculated using world prices for aluminum, which is not appropriate for Tajikistan, because its single large industrial concern, the Talco plant, actually exports aluminum through a tolling arrangement. Rather than selling its output at world prices, it has entered into a contract with an offshore company to export aluminum (and import inputs to the smelting process) at a fixed price. It has thus not been exposed to the vast drop in aluminum prices that has forced some smelters worldwide to shut their doors. Moers said he has on numerous occasions spoken with government officials to push them to use more accurate figures that reflect the tolling arrangement, but to no avail. Government statistics continue to seriously distort the effects of the crisis on Tajik exports. (Comment: Of course, when world aluminum prices are high, the tolling arrangement means the state of Tajikistan, which owns Talco, sees little of the great profits that are made by delivering electricity to the plant far below market value. The real money-makers are the President and members of his inner circle, who are believed to have financial control of the offshore company that buys from Talco. End comment.)

14. (SBU) While the drop in remittances is a real concern, Moers said that other indicators for Tajikistan are surprisingly positive. Inflation for the first half of this year was 6.7%, considerably reduced from 11.9% at year's end in 2008. And GDP has grown this year at a rate of 2.8%. While this is a good deal lower than last year's figure of 7.9%, it surpasses earlier IMF projections of 0%. Moers said the GDP figure bodes well for Tajikistan, although he admitted he was at a loss to explain it. According to Jamshed Rahmonberdiev, the CEO of Somon Capital, his company has conducted a number of market surveys indicating

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that domestic consumption has continued to grow steadily, even during the financial crisis. Construction and real estate in particular have remained strong (too strong, according to some organizations shocked by Dushanbe housing prices), which has contributed to GDP growth.

SOME GOOD REFORMS

15. (SBU) Moers was tentatively pleased with government efforts to improve the banking sector and investment climate. Many of these steps were conditions for renewed IMF assistance under its Poverty Reduction and Growth Facility (PRGF), which went into effect in April of this year. (The IMF had suspended assistance to Tajikistan early last year after the government admitted misreporting its reserves to hide unauthorized investments in the cotton sector.) The President recently signed a new law on commercial banking that significantly normalizes the sector. And new amendments to the central bank law, drafted with assistance from a World Bank consultant, were passed by the government and currently await the President's signature. These will provide for term limits for the chairman of the National Bank, require outside members on the Bank's board, and detail a number of other provisions designed to prevent conflicts of interest. Moers admitted that authorities were having some difficulty finding qualified outside board members, however.

16. (C) Moers said that the government's progress on putting together a debt resolution plan for the cotton sector has so far been more or less satisfactory (ref D). Donors, including the IMF, had insisted that the government wipe the slate clean for farmers who have accumulated a tremendous amount of debt while being forced by the government to grow unprofitable cotton

crops. Emphasizing that he was speaking personally, he said that he would have liked to see cotton investors shoulder much more of the debt, rather than leaving it to the Ministry of Finance to come up with the money. He had no confidence the government's figure for outstanding debt, \$548 million, had any basis in reality. While the ultimate cost will be a serious issue for the government budget, the key issue from his perspective is that the government make good on its pledge to wipe out farmer debt. (Note: During a donor meeting a month ago, Finance Minister Safarali Najmuddinov was overheard cursing former National Bank Chairman Murodali Alimardon and others for authorizing the use of state loans to fund their own cotton investments. Moers said he doubted that Najmuddinov was as far outside the loop as he wanted donors to think. End note.)

¶7. (SBU) The IMF has made it a firm requirement that the government budget meet a deficit target of 0.5% and maintain social sector spending at current levels. Moers said that the government appears to be barely meeting these targets, even if he was not thrilled about how they were doing it. The budget has been significantly reduced chiefly by cutting capital expenditures and running big wage arrears. The deficit target looks like it will be met, although only by including \$20 million in budget support from the World Bank, \$40 million from the Asian Development Bank, and a prospective 12 million Euros from the European Commission. Social spending at the end of June -- which the IMF uses as a test date in its progress appraisals -- appears to be just around the minimum level, perhaps falling short by a tiny amount. The government continues to devote massive resources to constructing the Roghun hydropower station, however.

KEY AUDITS INAUSPICIOUS

¶8. (C) In the wake of the misreporting scandal, the IMF had pushed the government to audit key state institutions, including the National Bank, the state electricity utility Barqi Tojik, and Talco. Moers said the Barqi Tojik audit, conducted by BDO Unicon, was done, but that the audit is confidential and cannot be released outside the government and the IMF. Moers said if the U.S. government is interesting in seeing the audit, we should try to request it through our IMF Executive Director. Moers would not discuss any of the details of the audit, but he

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did say it was "not very pretty."

¶9. (C) The Talco audit will be conducted by the Moscow office of the British accounting firm Moore Stephens, which submitted the lowest bid in an open tender. Although Tajik appropriation rules require accepting the lowest bidder, Moers said he nevertheless fought hard to get a first-tier firm to conduct the audit. He said he felt uncomfortable with the choice of Moore Stephens, which he suggested the government may have selected for reasons beyond their cheaper price tag. When asked directly, he said he had no reason to suspect that Talco was preparing to cook the books, but he thought that engaging a first-tier firm would make that more difficult. IMF leadership was not as concerned as Moers, however. IMF Tajikistan Mission Chief Axel Schimmelpfennig asked donors if they would consider paying the extra cost of a first-tier auditor -- a suggestion Moers said he knew was a non-starter -- and when no one spoke up the issue died.

¶10. (C) Moers said he was frustrated as well by the IMF's failure to broaden the terms of reference of the Talco audit.

While the terms do allow for investigating some of Talco's links to the offshore entity where the real money is made, that company, registered in the British Virgin Islands, remains off limits to auditors. Moers acknowledged, however, that getting the government to sign off on auditing the offshore firm was not only impossible in practical terms, but might exceed their legal authorities as well. Although it is an open secret that Tajikistan's top leadership use the British Virgin Islands firm to essentially launder Talco profits that might otherwise have gone to the state, the fact is that the tolling arrangement is a legal and commonly-practiced arrangement, and there is little the IMF or anyone else can do to force a private firm to undergo an audit.

¶11. (SBU) Following the infamous Ernst & Young special audit of the National Bank last year (ref E), the government arranged for KPMG to conduct a retroactive annual audit of Bank operations in ¶2008. The last annual audit of the Bank's financial statements was in 2005, by PricewaterhouseCoopers. According to the Ernst and Young audit, financial statements for 2006 and 2007 were not signed by PricewaterhouseCoopers because of "significant outstanding questions." As a result, there is no auditable basis for 2008 beginning-year figures. Moers said that KPMG will have to accept the bank's figures and move forward.

THANKS U.S. FOR KEEPING THE HEAT ON

¶12. (C) Summing up, Moers said he is cautiously optimistic about the government's progress. The financial crisis has actually helped by providing the government an incentive to be more cooperative with the donor community and more willing to undertake real reforms. He acknowledged, however, that the real hurdle is not passing new laws but actually implementing them. Emphasizing that he was speaking personally, he said he was pleased with the U.S. decision to vote against the recent PRGF at the IMF board (refs F and G). "It's borderline whether we should be involved here at all," he said, given the government's poor performance and apparent lack of interest in fiscal transparency. "We need not just carrots, but sticks to remind them that we're serious. The IMF is very serious right now. But your vote on the PRGF reminds them not to take us for granted." The government's further progress this year will be assessed during an IMF mission in the second half of September.

¶13. (C) Comment: The IMF has had a somewhat inconsistent position on Tajikistan over the past year. It appeared to be rather soft on the government in the wake of the misreporting scandal, and its public pronouncements emphasized progress rather than the serious continuing problems. On the financial crisis, the IMF began the year quite optimistic about Tajikistan's position, but became progressively more concerned. Moers' candid comments show that there have been some real internal deliberations on both subjects. This is reassuring for the U.S., since it indicates that our critical and cautious

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approach has a constituency in the IMF and the donor community. At the same time, it provides some justification for the IMF's position that the government has made some forward progress, indicating that this assessment is based on real internal dialog rather than, as some have worried, merely a general inclination to be lenient. End comment.
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